

**JOINT STATEMENT
BEFORE THE ILLINOIS DEPARTMENT OF REVENUE
REGARDING NEW SALES TAX SOURCING REGULATIONS**

December 12, 2013

**ILLINOIS CHAMBER OF COMMERCE
ILLINOIS MANUFACTURERS' ASSOCIATION
TAXPAYERS' FEDERATION OF ILLINOIS
ILLINOIS RETAIL MERCHANTS ASSOCIATION**

We applaud the Department of Revenue for moving quickly to seek input from all parties impacted by the *Hartney Fuel Oil* decision before moving forward with any rulemaking activity or future guidance to taxpayers. We encourage the Department to continue to work with the business community and local government representatives to develop a local sourcing regulation, legislative language, or both that is fair to all and yet provides ease in administration and reasonable certainty for the retailers charged with collecting local taxes.

IDOR Rulemaking

The Department has referenced the possibility of using the Administrative Procedure Act's peremptory rulemaking authority to adopt regulations interpreting the *Hartney* decision. We believe that this would be the wrong approach to take, as it circumvents the normal rulemaking procedures that allow for public comment and participation in developing proposed regulations and because we do not believe that the Department has the authority to issue a peremptory rulemaking in response to the *Hartney* decision.

The Administrative Procedure Act (5 ILCS 100/5-50) defines a peremptory rulemaking as follows:

"Peremptory rulemaking" means any rulemaking that is required as a result of federal law, federal rules and regulations, an order of a court, or a collective bargaining agreement pursuant to subsection (d) of Section 1-5, under conditions that preclude compliance with the general rulemaking requirements imposed by Section 5-40 and that preclude the exercise of discretion by the agency as to the content of the rule it is required to adopt.

The Joint Committee on Administrative Rules' own regulation Section 240.100(a) quotes the above statutory language and then adds:

"...the Joint Committee believes that public notice and comment is an essential part of the rulemaking process, which should only be by-passed for very serious reasons. The peremptory process may be used only in situations in which the agency has no discretion as to the content of the rule and when the agency is precluded from complying with the general rulemaking requirements of the Act."

In this instance, we believe that any regulations proposed at this time would necessarily involve discretionary policy positions of the Department of Revenue and that there are clearly no impediments to the Department proceeding with normal rulemaking procedures. As a result, both the APA and JCAR rules would appear to prohibit the use of peremptory rulemaking in response to the *Hartney* decision.

The Joint Committee on Administrative Rules (JCAR) has acted in the past to prohibit an agency from using peremptory rulemaking in a similar situation. See, JCAR Statement of Objection and Suspension of Peremptory Rulemaking, 32 Illinois Register 7212, May 2, 2008, to Department of Health & Family Services. In that case, a court had enjoined enforcement of an emergency rulemaking of HFS that it found not to be in compliance with statutory requirements. HFS then proceeded to issue peremptory rules to address the court's specific criticisms. JCAR ruled that:

"The court order does not direct HFS to amend its rules in any way, including insertion of employment and job search requirements, nor does the court set any deadline for action that precludes the use of regular rulemaking procedures. Therefore, the standards under Section 5-50 of the IAPA for use of peremptory rulemaking are not met, and JCAR finds this violation of the IAPA presents a threat to the public interest."

We urge the Department to comply with the IAPA and promulgate any proposed sourcing regulations through normal rulemaking procedures that allow for public comment and participation of all affected parties.

Need for clear guidance

Hartney Fuel Oil v. Hamer is a major case in Illinois tax law, and the list of parties impacted by the decision is a long one. Taxpayers, retailers, the Department, and local governments all have a stake in the case's outcome and aftermath. A major tenet of good tax policy is predictability, and each of these groups deserves clear, workable guidance in response to *Hartney*.

The Department's initial statement correctly indicated that there are many retailers whose operations are small or simple enough that the Supreme Court's decision does not affect them. However, the group of taxpayers and retailers looking to the Department for guidance is quite large, and includes many of the State's largest tax-collectors. Traditional retailers with more than a brick-and-mortar presence, business-to-business sellers with multiple locations, sellers with multiple sales methods (sales force, cash-and-carry, internet, etc.)—all of these businesses and more need to understand what local taxes, if any, apply to their transactions.

All sellers, whether those who structured their businesses in order to comply with the prior regulation, or those who simply applied it to their existing practices, are still required to collect tax after *Hartney*, and they should be given instructions that allow them to do so with a reasonable modicum of certainty.

Whatever regulation is ultimately drafted, it needs to contain a bright-line test so retailers can easily comply with the law and not be exposed to problems and liabilities after the fact. There are downsides

to failing to provide clear guidance; the State's tax-collectors should not be left holding the bag for a tax they would have been able to collect from the true tax-payers had there been sufficient guidance.

Some have pointed to a lack of clarity elsewhere in tax laws, but this does not justify uncertainty here. In the income tax arena, for example, it is the taxpayer's own liability that is at issue, and the gray areas are evaluated once a year as part of the annual return-filing process, with the benefit of months of hindsight and deliberation before the final tax calculation is made. Sales taxes must be calculated and collected real-time, in some cases for hundreds or even thousands of transactions each day, and the "which local tax" question must be answered each time—long and complicated deliberations over gray areas are simply not possible.

We have identified several fact patterns that, while far from exhaustive, illustrate the depth and breadth of this issue.

- A customer places an order with a seller, through a website or online call center, and has no contact with the seller's retail store except that the customer picks up the merchandise there—is the transaction sourced to the store's location? Does it matter if the retailer's other activities associated with that sale all occurred outside Illinois?
- A customer places an internet order while physically located in a retailer's only Illinois store and the order is processed by the system (accepted out-of-state, fulfilled from a warehouse out-of-state, etc.) just as if the order had been placed from the customer's home. Is that enough to convert what was traditionally considered a use tax transaction not associated with a particular in-state location to an in-state transaction subject to the rate in effect at that store?
- If the seller's only in-state activity associated with a transaction is order acceptance, is that transaction now a use tax transaction not subject to any local ROT?
- Many sellers spend considerable time and money designing, sourcing and procuring inventory—is that a relevant factor? It is a necessary part of the business of retailing.
- A customer places a large order of widgets with retailer's sales representative. Although the sales rep is at one of the retailer's sales offices, the retailer's home office in a different jurisdiction approves the sale, processes the order, evaluates the business's credit-worthiness, checks inventory availability, stores inventory, fulfills orders, etc. The next day, the customer decides to order additional widgets, places an order online, and the identical process follows, but without the sales rep. Assume the local tax rates differ for each location. Would different tax rates apply to these two transactions, even though from the business customer's perspective they are virtually identical?
- Traditionally, the first question to ask when evaluating what tax rate to apply is whether a sale occurs in Illinois, and if so the next question is what local jurisdiction may subject the transaction to its local ROT. (*Hartney* dealt only with the second question.) Do the same factors apply when answering both of these questions?
- Will businesses with direct pay permits now need to evaluate their seller's business practices in order to determine what local ROT to pay?

We realize the task of formulating a simple yet comprehensive rule that can be easily applied by taxpayers, retailers, and auditors alike is not an easy one. However, it is the responsibility of the Department of Revenue not just to enforce but to fairly administer the State's tax laws—this responsibility cannot be abdicated here simply because it is difficult.

Hartney does not preclude clear guidance

The single-factor bright-line test in the Department's long-standing regulation has been stricken. That does not mean no test is permitted, or that the new test cannot be easy to administer and clear-cut. For example, the Department could specify a short list of relevant factors, and so long as the Department also indicates how the factors should be weighed (by cost, or maybe by hours expended), sellers should be able to comply. In other words, the concept of the "totality of the circumstances," "composite of many activities," "predominant selling activities," or whatever the preferred phrase to describe the Supreme Court's mandate, does not in turn mandate chaos.

Earlier legislative and regulatory attempts at providing a standard for local sourcing were, unfortunately, unworkable and should not be used as a template for the Department's new regulations on this topic. They were too subjective, too complicated, and did not provide any certainty or reflect how modern business is conducted. These proposals frequently contained a broad catch-all clause at the end of a long laundry list of unweighted factors—virtually guaranteeing backward-looking second-guessing in all but the simplest of transactions. If a bright-line test based on one universally present selling activity is not possible under current law, the test can and should still be simple and easily applied.

Illinois already carries the dubious distinction of having the most complicated sales tax system in the nation. We implore the Department to work closely with the stakeholders to ensure that whatever regulations come out of *Hartney*, Illinois' reputation does not suffer another blow.

Thank you again.